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## ANNUAL AUDITED REPORT

FORM X-17A-5

PART III

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Information Required of Brokers and Dealers Pursuant to Section 17 of the  
Securities Exchange Act of 1934 and Rule 17a-3<sup>11</sup> Thereunder

REPORT FOR THE PERIOD BEGINNING 01/01/2007 AND ENDING 12/31/2007  
MM/DD/YY MM/DD/YY

## A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Direct Trading Institutional, L.P.

OFFICIAL USE ONLY

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

FIRM I.D. NO.

8115 Preston Road

(No. and Street)

Dallas

TX

75225

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Timothy Dunham

201-557-6886

(Area Code - Telephone Number)

## B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report\*

PricewaterhouseCoopers

(Name - if individual, state last, first, middle name)

300 Madison Avenue

New York

NY

10017

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

☒ Certified Public Accountant☐ Public Accountant☐ Accountant not resident in United States or any of its possessions.

PROCESSED

MAR 31 2008

THOMSON  
FINANCIAL

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\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

SEC 1410 (06-02)

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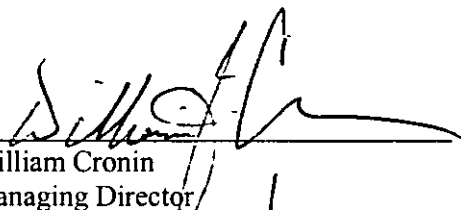
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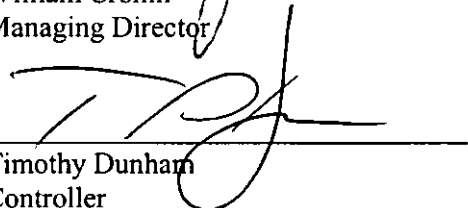
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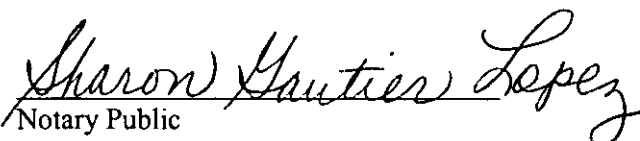
STATE OF NEW JERSEY

COUNTY OF HUDSON

We, the undersigned officers of Direct Trading Institutional, L.P., affirm that, to the best of our knowledge and belief, the accompanying financial statements and supplementary schedules pertaining to Direct Trading Institutional, L.P. as of December 31, 2007 are true and correct. We further affirm that neither the Company nor any principal officer or member has any proprietary interest in any account classified solely as that of a customer.

  
William Cronin  
Managing Director

  
Timothy Dunham  
Controller

  
Notary Public

**SHARON GAUTIER LOPEZ**  
**Notary Public, State of New Jersey**  
**No. 2271908**  
**Qualified in Hudson County**  
**Commission Expires August 3, 2011**

**Direct Trading  
Institutional, L.P.**  
Statement of Financial Condition  
December 31, 2007

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Washington, DC  
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**Direct Trading Institutional, L.P.**

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**December 31, 2007**

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**Report of Independent Auditors**

To the Partners of  
Direct Trading Institutional, L.P.:

In our opinion, the accompanying statement of financial condition presents fairly, in all material respects, the financial position of Direct Trading Institutional, L.P. (the "Partnership") at December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. This financial statement is the responsibility of the Partnership's management; our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit of this statement in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the statement of financial condition is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement of financial condition, assessing the accounting principles used and significant estimates made by management, and evaluating the overall statement of financial condition presentation. We believe that our audit of the statement of financial condition provides a reasonable basis for our opinion.

*PricewaterhouseCoopers LP*

February 28, 2008

**Direct Trading Institutional, L.P.**  
**Statement of Financial Condition**  
**December 31, 2007**

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*(in thousands)*

**Assets**

Cash and cash equivalents	\$ 2,892
Receivable from brokers, dealers and clearing organizations	18,961
Fixed assets at cost, less accumulated depreciation of \$161	738
Goodwill	43,771
Intangible assets, less accumulated amortization of \$5,746	14,254
Other assets	<u>481</u>
Total assets	<u>\$ 81,097</u>

**Liabilities and Partners' Capital**

**Liabilities**

Accrued soft dollar and commission recapture expense	\$ 4,533
Payable to brokers, dealers and clearing organizations	1,125
Accrued compensation expense	919
Payable to affiliates	928
Accrued expenses and other liabilities	<u>535</u>
Total liabilities	8,040

Commitments and contingent liabilities (Note 5)

Partners' capital	<u>73,057</u>
Total liabilities and partners' capital	<u>\$ 81,097</u>

The accompanying notes are an integral part of this financial statement.

**Direct Trading Institutional, L.P.**  
**Notes to Statement of Financial Condition**  
**December 31, 2007**

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**1. Organization and Description of the Business**

Direct Trading Institutional, L.P. (the "Company"), a limited partnership organized in the state of Delaware, provides institutions with direct access trading through an advanced electronic platform. The Company is registered as a broker-dealer with the Securities and Exchange Commission ("SEC") and is a member of the Nasdaq Stock Exchange, the Financial Industry Regulatory Authority ("FINRA") and National Futures Association. The Company's general partner is DT Holdings (GP) LLC and its limited partner is DT Holdings (LP) LLC. The Company's ultimate parent is Knight Capital Group, Inc. ("KCG").

**2. Significant Accounting Policies**

**Cash and Cash Equivalents**

Cash equivalents represent money market accounts which are payable on demand, or short-term investments with an original maturity of less than 90 days. The carrying amount of such cash equivalents approximates their fair value due to the short-term nature of these instruments.

**Estimated Fair Value of Financial Instruments**

Management estimates that the fair value of financial instruments recognized on the Statement of Financial Condition (including receivables, payables and accrued expenses) approximates their carrying value, as such financial instruments are short-term in nature, bear interest at current market rates or are subject to frequent repricing.

**Goodwill and Intangible Assets**

The Company applies the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142 *Goodwill and Other Intangible Assets*, which requires that goodwill and intangible assets with an indefinite useful life no longer be amortized, but instead, be tested for impairment annually or when an event occurs or circumstances change that signify the existence of impairment. The Company has no intangible assets with indefinite lives. Other intangible assets are amortized on a straight line basis over their useful lives, and as required by SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, will be tested for recoverability whenever events indicate that the carrying amounts may not be recoverable.

**Accrued Soft Dollar Expense**

The Company conducts some of its business within the safe harbor of Section 28(e) of the Securities Act of 1934 as amended. The Company executes brokerage transactions for its customers at a negotiated commission rate. As an incentive to use the facilities of the Company for the execution of such brokerage transactions, the Company has developed a system to provide third party research services to certain of its clients based upon the frequency of use of its facilities.

Third party research paid for in advance of the execution of brokerage transactions is reflected as an asset and expensed as the related commission income is earned. A liability is recorded for research expense when commission income is earned. Prepaid research expense incurred on behalf of clients that elect not to use the facilities of the Company for the execution of brokerage transactions will be expensed at the time it is determined the facilities will not be used. At December 31, 2007, the Company had approximately \$291,048 in prepaid research expense included within Other assets on the Statement of Financial Condition.

**Depreciation, Amortization and Occupancy**

Fixed assets are being depreciated on a straight-line basis over their estimated useful lives of three to seven years. Leasehold improvements are being amortized on a straight-line basis over the

**Direct Trading Institutional, L.P.**  
**Notes to Statement of Financial Condition**  
**December 31, 2007**

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shorter of the life of the related office lease or the expected useful life of the assets. The Company records rent expense on a straight-line basis over the lives of the leases.

**Stock-Based Compensation**

On January 1, 2006, the Company (in conjunction with KCG) adopted SFAS 123-R *Share-Based Payment* ("SFAS No. 123-R") using the "modified prospective approach." Under SFAS No. 123-R, the grant date fair values of stock-based employee awards that require future service are amortized over the relevant service period.

Upon the adoption of SFAS No. 123-R, the Company changed its expense attribution method for options. For option awards granted subsequent to the adoption of SFAS No. 123-R, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award, which is the same methodology that the Company uses to account for restricted share awards. For unvested option awards granted prior to the adoption of SFAS No. 123-R, the Company will continue to recognize compensation cost using a graded-vesting method (as it had on a pro-forma basis previously). The graded-vesting method recognizes compensation cost separately for each vesting tranche.

Additionally, SFAS No. 123-R requires expected forfeitures to be considered in determining stock-based employee compensation expense. For the year ended December 31, 2007, the firm recorded a benefit for expected forfeitures on all outstanding stock-based awards.

For stock-based payments issued after the adoption of SFAS No. 123-R, the Company applies a non-substantive vesting period approach whereby the expense is accelerated for those employees that receive awards and are eligible to retire prior to the award vesting.

**Income Taxes**

As a limited partnership, the Company is not subject to federal, state or local income taxes as such amounts are borne by the Company's partners.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of assets and liabilities at the date of the Statement of Financial Condition. Actual results may differ from these estimates.

**3. Fixed Assets and Leasehold Improvements**

Fixed assets and leasehold improvements comprise the following:



**Direct Trading Institutional, L.P.**  
**Notes to Statement of Financial Condition**  
**December 31, 2007**

*(in thousands)*

Leashold improvements	\$	503
Furniture and fixtures		308
Computer hardware		45
Computer software		38
Equipment		5
		<u>899</u>
Less: Accumulated depreciation		161
	\$	<u>738</u>

**4. Goodwill and Intangible Assets**

At December 31, 2007, the Company had goodwill and intangible asset balances of \$43.8 million and \$14.3 million, respectively, which resulted from the purchase of Direct Trading Institutional, Inc. in June of 2005 and contingent payments made in the third quarter of 2006 of \$12.5 million and the third quarter of 2007 of \$10.3 million.

The intangible assets, which are primarily customer relationships, are all deemed to have finite lives and are being amortized over their useful lives, which have been determined to range from two to thirty years.

Under SFAS 142, Goodwill and the useful lives of intangible assets are tested for impairment, at a minimum, annually or when an event occurs or circumstances change that signify the existence of impairment. As part of the test for impairment, the Company's goodwill and intangible assets are tested in conjunction with the Company's business segment within KCG. The test considers the profitability, assessment of fair value as well as the overall market value of the Company and its business segment compared to the net book value. In June 2007, the Company tested for the impairment of goodwill and intangible assets and concluded that there was no impairment. Additionally, no events occurred in 2007 that would indicate that the carrying amounts of the Company's amortizable intangibles may not be recoverable.

**5. Commitments and Contingent Liabilities**

The Company leases certain computer and office equipment under noncancelable operating leases. As of December 31, 2007, future minimum rental commitments under all noncancelable office leases and computer and equipment leases are as follows:

*(in thousands)*

<b>Year Ending December 31,</b>		
2008	\$	285
2009		254
2010		196
2011		176
2012		181
Thereafter through 2017		<u>1,111</u>
	\$	<u>2,203</u>

**Direct Trading Institutional, L.P.**  
**Notes to Statement of Financial Condition**  
**December 31, 2007**

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From time to time, the Company has been named as a defendant in legal actions and is subject to inquiries by various regulatory and self-regulatory bodies. In the opinion of management, based on consultation with legal counsel, any adverse outcome with regard to these potential matters would not likely have a material adverse effect on the operations or the financial position of the Company.

**6. Significant Clients**

The Company considers significant clients to be clients who account for 10% or more of total revenues net of soft dollar and commission recapture expense of the Company during the year. For the year ended December 31, 2007, no client accounted for more than 10% of the Company's revenues net of soft dollar and commission recapture expense.

**7. Employee Benefit Plans**

KCG sponsors a 401(k) profit sharing plan (the "Plan") in which substantially all employees are eligible to participate. Under the terms of the Plan, the Company is required to make contributions to the Plan equal to 100% of the contributions made by each Company participant, up to certain limits.

Certain employees of the Company participate in KCG's stock option and award plans (the "Stock Plans"). The purpose of the Stock Plans is to provide long-term incentive compensation, in the form of KCG stock-related awards, to employees of the Company.

Eligible employees receive KCG restricted shares as a portion of their total compensation. Restricted share awards generally vest ratably over three years. KCG has the right to fully vest employees in their option grants and awards upon retirement and in certain other circumstances. Awards are otherwise canceled if employment is terminated before the end of the relevant vesting period.

KCG's policy is to grant options for the purchase of shares of KCG Class A Common Stock at not less than market value, which the Stock Plans define as the average of the high and low sales price on the date prior to the grant date. Options generally vest ratably over a three or four-year period and expire on the fifth or tenth anniversary of the grant date, pursuant to the terms of the option agreements. KCG has the right to fully vest employees in their awards upon retirement and in certain other circumstances. Awards are otherwise canceled if employment is terminated before the end of the relevant vesting period.

**8. Related Party Transactions**

The Company pays an affiliate a fee for executing certain transactions and performing certain administrative functions with shared customers. At December 31, 2007, the Company owed \$680,000 related to these transactions. This amount is included within Payable to affiliates on the Statement of Financial Condition.

Certain expenses are allocated to the Company by KCG or an affiliate of the Company based on direct usage. These bills are paid by KCG or the affiliate, as they are usually part of larger bills of KCG and its affiliates. The amounts owed to KCG and its affiliates are paid on a timely basis by the Company. At December 31, 2007, the Company owed \$248,000, related to these corporate overhead expenses, to KCG and its affiliates. This amount is included within Payable to affiliates on the Statement of Financial Condition.

**Direct Trading Institutional, L.P.**  
**Notes to Statement of Financial Condition**  
**December 31, 2007**

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**9. Financial Instruments with Off-Balance Sheet Risk and Concentrations of Credit Risk**

The Company clears all of its securities transactions through a clearing broker on a fully disclosed basis. Accordingly, substantially all of the Company's credit exposures are concentrated with the clearing broker. Additionally, pursuant to the terms of the agreements between the Company and the clearing broker, the clearing broker has the right to charge the Company for all losses that result from a counterparty's failure to fulfill its obligations. The Company has the ability to pursue collection from or performance of the counterparty. The Company's policy is to monitor the credit standing of the clearing agent and all counterparties with which it conducts business.

As the right to charge the Company has no maximum amount and applies to all trades executed through the clearing broker, the Company believes there is no maximum amount assignable to this right. At December 31, 2007, the Company has recorded no liabilities with regard to the right.

**10. Net Capital Requirement**

As a registered broker-dealer and a FINRA member firm, the Company is subject to the SEC's Uniform Net Capital Rule (the "Rule") which requires the maintenance of minimum net capital. The Company has elected to use the basic method, permitted by the Rule, which requires that the Company maintain net capital equal to the greater of \$100,000 or 6 2/3% of aggregate indebtedness, as defined.

At December 31, 2007, the Company had net capital of \$12.9 million which was \$12.3 million in excess of its required net capital of \$536,000.